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THE BIDDING WARS: MORTGAGE EXCHANGES FORCE COMMODITIZATION

Virtual mortgage exchanges are Web sites, complete with loan approvals, where borrowers & lenders pair off. In reality, though, these online forums will foster a new competitive model, where banks must compete electronically for consumers' business.

BY ANDREW REINBACH

All revolutions mean changing the balance of power, and the revolution now sweeping the world of finance is no exception; consider, for instance, the simple matter of home mortgages.

As any banker knows, there are oceans of money in the seemingly prosaic home mortgage business; according to the Mortgage Banker's Association, originations in 1995 totalled $635.8 billion, while the Federal Reserve says total U.S. residential mortgage assets in the last quarter of 1995 totalled $3.683 trillion.

With money like that in the balance, it's no surprise lenders have striven to preserve the whip hand. And indeed, for most people, borrowing money to buy a house usually seems to mean offering the bank a blood sample and your first born, a notion bankers have done little to dispel.

What bankers have neglected to tell their supplicants, however, is that as far as the law and the facts of business have gone, the whip hand has always really belonged to the borrower. The borrower owns the house; the borrower owns the income stream from the mortgage; the borrower owns the puts and calls implicit in the mortgage; the borrower, in fact, owns and gives the mortgage. What the bank brings to the table is money, with which it buys a lien, and the lien's income stream, so the bank can package the income stream, sell it, and service it, collecting fees at every step. In the best of all possible worlds, therefore, borrowers with good credit should have been able, lo these many years, to pick and choose among supplicant lenders. But, as generations of homeowners can attest, that's not exactly how it's played out.

THE VIRTUAL SPIN ON COMMODITIZED PRODUCTS

Enter now the Internet, and with it, the Lender's and Borrower's Exchange (LBEX), which, if successful, stands to revolutionize the mortgage origination business.

The brainchild of John and Joan Chambless, the LBEX, which will open its Web Site for business in December (lbex@aecorp.com), will be an electronically leveled playing field

understand what the difference between the various products and rates really mean," says Otto. "So you're making the process easier and less expensive for a select group of people."

Of course, 15 percent of the residential mortgage business's annual volume means something in the neighborhood of $95 billion—a comfortable neighborhood if there ever was one. And the better quality borrowers are what lenders want, so the LBEX idea will potentially cream off the A credit mortgagors, who not only generally represent the larger mortgages, but also the most homogeneous and easily packaged loans. This would leave the more traditional, aloof lenders with mortgages that would have, among other things, higher underwriting costs—and higher default rates.

SQUEEZING THE REGIONAL PLAYERS

As a result, says Otto, the LBEX idea will eventually become an important element in the market. "On the tougher loans, the lower quality loans, there's probably going to have to be some personal hand-holding. But initially, you can probably skim off 15-to-20 percent of the better quality loans, which means you won't need a loan officer or a mortgage broker. Over time, in my opinion, it will be perfected to where fewer and fewer loan officers and brokers will be required, though there will come a time where there will be diminishing returns, and those will be the loans that will require personal attention."

What it will also mean is another chapter in the ongoing squeeze endured by the nation's medium-sized, or regional, banks." I really do believe that you'll have your behemoths and your smaller boutique lenders, and the middle guys are the ones that will be sliced out," says Otto.

Such a potential fate—and the need to avoid it—has not eluded the denizens of all walks of the mortgage business. Many of the big national banks already have some mortgage application capacity on their Web sites, and so do mortgage bankers ranging from the nation's largest independent, Pasadena, CA-based Countrywide Mortgage Corp., and its $34.6 billion in 1995 origination volume, to West Des Moines, IA-based Allied Group Mortgage Co., which originated about $400 million last year.

Both companies, in fact, have Web Sites that allow mortgagors to apply—and get preliminary commitments—online; Countrywide's since October 9 and Allied's since last Fall. Allied's Web site, in fact, is not dissimilar to the LBEX—aside from the fact that it's proprietary and that their listings are not in competition with other companies at that site. "We have a pretty extensive Web Site with several pages, and people have various options that they can choose, from an application to selling us business," says Joanne Kunz, Allied's vp of production.

So far, says Kunz, in what may be a warning for Chambless's aspirations, Allied's experience hasn't been so great. "It really hasn't [taken off] yet, but we expect it to at some point," says Kunz. "We get more questions than anything on the Internet. We've had a lot of inquiries and a lot of applications that don't turn into loans, [but] we have closed, I think, maybe eight or nine; so we're talking about a very small amount, but the application feature has only been on the site for about four months."

Despite Allied's initial experience, Kunz thinks the Internet is an important venue for almost any lender. "I think [something like the LBEX] would be attractive to us, if we didn't have our own Web site," she says." I think more and more companies are heading in that direction, because they're finding it important to be on the Internet; there's merit to it."

But Web sites like the LBEX won't do many favors for people like Kunz' independent, commission-only correspondents, who comprise, she says, something like half of her company's originations. "Personally," she says, "I think that's a thing of the past. That has already started to change, and I think that will continue to change." The bottom line: squeezing correspondents out of the A credit market, and leaving them with loans that are both tougher to underwrite, and tougher to sell.

For banks, whether Web site mortgage exchanges like the LBEX do any favors for Main Street mortgage brokers is incidental; what's important is what such ventures mean for banks. And few bankers harbor many illusions about what ventures like the LBEX mean to them, or how they must meet the challenge.

Take, for example, Tony Murt, vp of mortgage lending of Paducah, KY-based Citizen Bank and Trust, which has $950 million in assets, $225 million of which are mortgages. "Obviously, conventional delivery methods are not going to [continue] being a way of life, and to the extent that new delivery systems relate to that, there's a lot of opportunity out there," he says. On the other hand, though, "I don't know that I necessarily like [losing the balance of power with customers]; no industry wants to lose the balance of power. But you either have to figure out ways to compete against it, or do what you need to do."

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Despite the activities of companies like LBEX and FormNet, the business case for Web-based residential mortgage exchanges remains sketchy. The problem is that virtual mortgage exchanges do not address the need of most consumers to be educated on the intricacies of mortgage products, says Scott Cooley, president of Contour Software, a mortgage origination software company based in Campbell, CA.

For most would-be owners, Cooley argues, buying a home is the biggest purchase of a lifetime, and details such as long-term financial goals, mortgage product alternatives, expected length of residence in the home and a laundry-list of other factors play into mortgage decisions not likely to be effectively facilitated over the Internet. "For the vast majority of consumers out there, the process of getting a home loan is so confusing, so daunting with all of the regulations and paperwork."

He does, however, see an opportunity for banks to work with customers via the Web to re-finance mortgages. ■